

“Well placed?”

NZ Economics Team:

Cameron Bagrie

Chief Economist
Telephone: +64 4 802 2212
E-mail: bagriec@anz.com

Khoon Goh

Senior Economist /
Interest Rate Strategist
Telephone: +64 4 802 2357
E-mail: gohk@anz.com

Philip Borkin

Economist
Telephone: +64 4 802 2199
E-mail: borkinp@anz.com

Steve Edwards

Economist
Telephone: +64 4 802 2217
E-mail: edwards1@anz.com

Kevin Wilson

Economist
Telephone: +64 4 802 2199
E-mail: wilsonk1@anz.com

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ECONOMIC OVERVIEW

Strong labour market data has confirmed inflation risks and good late cycle support. Domestic data this week is expected to take on a soft tone with housing particularly weak. Drought conditions are adding to downside growth risks although the rain overnight is welcome. International events remain influential in our eyes. US looks to have slipped into recession, and Europe is slowing. It just seems a question of time before we see some concrete impact on NZ.

What's ahead?

- > **REINZ January Housing Report** (circa 11 February). The major indicator here is average days to sell a house. With listings rising and sales subdued, we expect this to rise beyond last month's level of 40 days (seasonally adjusted).
- > **NZ December quarter PPI** (Wednesday 1045 NZDT). We expect a 1.8 percent rise in input prices and a 1.3 percent rise in output prices, underpinned by oil and commodity prices. The "gap" between the two should portend of continued margin pressure.
- > **NZ December quarter Capital Goods Price Index** (Wednesday 1045 NZDT). We expect plant and machinery prices to fall due to higher TWI, but residential and non-residential building prices to remain strong.
- > **NZ January Food Price Index** (Thursday 1045 NZDT). January is usually a strong month for food prices, and this year will be no different. With world commodity prices still riding high, there is further agri-inflation in the works.
- > **NZ December Retail Sales** (Friday 1045 NZDT). After a strong surge in November, a pullback can be expected. Credit card and ECT data point to a soft print. We expect a small decline in headline sales but a small rise in core sales. For the quarter, we expect soft volume growth of 0.3 percent.

What's the view?

The local focus last week was all about the labour market and the data released confirmed without doubt that the labour market is tight. Employment growth surged 1.1 percent in the December quarter, the unemployment rate dropped to a new record low of 3.4 percent, and annual Labour Cost Index wage growth (a pure wage inflation measure) hit an all-time high of 3.5 percent. The tightness of the labour market is not really new news, but the data has certainly intensified confirmation of the late cycle support the economy is experiencing and the extent of inflationary risks the Reserve Bank face. The fact that the female participation rate hit an all-time high of 62.4 percent, and employment growth was the strongest for those aged 60 and over (at a whopping 10 percent on an annual basis), confirms that labour

supply remains tight. Weakening net migration numbers (with only a net 20 people arriving in December, taking the annual net inflow to the lowest level since 2001) is often cited for its link to the property market, but its also a key source of labour supply, that is absent.

Strong wage increases are by no means a bad development; we all want to be paid more. In fact, given the extent of increases in the price of core staples, higher mortgage payments, and evidence that house prices are beginning to soften, strong wage growth will be needed for some households whose disposable incomes are being eaten away by costs and debt servicing. However, the problem is that these wage increases are not being accompanied by productivity growth improvements. We keep harping on about it, but productivity growth across the market sector has averaged a woeful 1.3 percent since 2001, roughly half the rate apparent over the 1990's.

Wages and unemployment rate



In fact, consider this. Wage growth according to the unadjusted Labour Cost Index (which captures headline wage gains as opposed to wage inflation alone in the cost index mentioned earlier) has averaged a tad over 4.5 percent since 2001. Inflation has averaged 2.6 percent. Now 2.6 percent inflation compensation plus a productivity gain of 1.3 percent per year does not add up to 4.5 percent. So it's folly to say wages are lagging inflation and productivity. They are creeping ahead. Labour's (employees) share of GDP has rocketed to a 17-year high. Certainly we need to be careful making sweeping assessments as the time period (2001-2007) covers a cyclical upswing in the labour market. But cyclical upswings do not last forever, and neither can wage gains in excess of inflation and productivity. The trend is undermining the nation's and businesses' competitiveness.

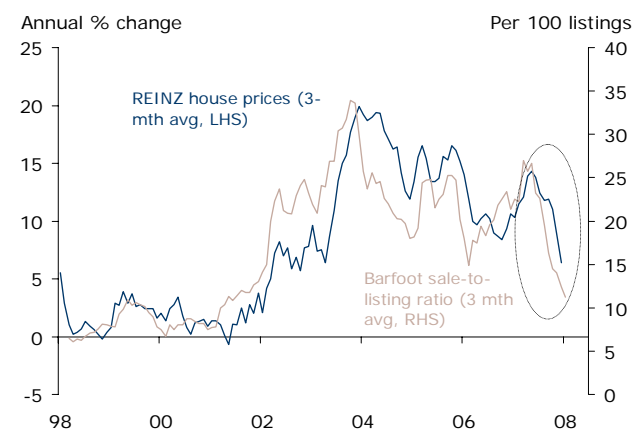
We saw some encouraging signs on the productivity front around the middle of last year. However it has clearly not been sustained (on the assumption that GDP growth was modest in the December quarter). We were also taken by the robustness across employment intentions but weakening investment intentions from the NZIER's QSBO survey. We read this as a nasty signal for where productivity growth is headed. There seems no limit to the amount of jobs

on offer, yet firms are cautious about investing. Both are counter to the price signals being received with the cost of labour rising, and capital falling.

Poor productivity growth is exacerbating the Reserve Bank's inflation problems at present. If it wasn't for the uncertainties facing the global economy, and clear evidence that the housing market is soft, we suspect the Bank would be tempted to pull the interest rate lever once again.

But what about the weak housing market? Last week's Barfoot and Thompson data reinforced weakness in the housing market with house sales down 40 percent on a year ago and house prices falling 7.5 percent over January. (The latter series is volatile so we don't tend to read too much into it). In fact the term weak is an understatement. What struck us about the data was a continued increase in available listings, with 9 months supply now available. To put this in perspective, the US housing market is in free-fall, with 11 months supply. The website www.realestate.co.nz is reported as having a 35 percent jump in listings over the past year. Quotable Value statistics report annual growth at 8 percent, but in fact prices have fallen since October.

House prices vs sale-to-listing ratio



Sources: ANZ National, Statistics NZ, REINZ, Barfoot & Thompson

For now, we remain in a holding pattern watching the data, and waiting for housing related softness to diffuse through to the broader economy. We are in no doubt monetary policy is working, so we are far from inclined to join the chorus for higher rates, or place a high probability on a hike at this juncture.

But one wonders the end-game for housing when the unemployment rate starts to nudge up, a development that is a certainty if inflation pressure is to ease.

We've pencilled in a 5 percent fall in house prices at present, but the bias looks tilted towards something bigger. While history (1997/98 and 2000/01) tells us that house prices fall very little, the "boom" was the biggest in history, so we suspect we are in new territory when it comes to suggesting how far the retrenchment could be.

Looking at the broad picture, there is no doubt NZ finished 2007 on a good note despite a progressively weaker housing sector. Yet we get the feeling from our discussions, and looking at early nuances for 2008,

that conditions are looking dicey. Momentum has not been sustained.

Financial conditions have continued to tighten, and in fact are the tightest since 1996. Dairy prices have started to ease and the currency has pushed up at the same time. Early reads on confidence in the new-year from various chambers of commerce are not encouraging. Finance company "issues" are starting to resurface. Top-tier businesses are now facing the reality that they (NZ) are not immune to the progressive re-pricing of risk via funding costs. We'll be closely watching how this feeds into investment plans.

A big wild-card at present is weather conditions. We highlighted last week the dry conditions plaguing much of the country at present. Fonterra have announced it could cost farmers as much as \$500 million this season. Many sheep and beef farmers are having to send stock to slaughter early due to a lack of feed. Morale is low, although a week of solid rain could change the picture. The rain over the past 24 hours in parts of the country will certainly help, so watch this space. But if the rural cheque-book disappears, we would be left with one engine of growth: the Government. Dr Cullen confirmed last week that tax cuts will be delivered, albeit using a cautious three-year implementation strategy. Additional infrastructure work is also pending, with an announcement of a \$2 billion tunnel to complete Auckland's Western Ring Route.

Turning to this week, once again we expect international events to be influential as far as broad currency and interest rate direction, but also the risk profile surrounding the economy. Last week was notable for weakness in key European indicators and the US ISM non-manufacturing data falling to the lowest level in seven years. Equity markets were once again volatile, although generally ended the week lower as they continue to play bungee-nomics. The BoE cut rates a further 25bps and although the ECB left rates unchanged, a softer tone has started to emerge. Actions and stances by both (the BoE hiked in July, but cut five months later, the ECB was incredibly hawkish only a week ago), leave us comfortable calling easings by the RBNZ before the end of the year. Global unease remains credit-centric, it's extending beyond the US, and we struggle to see the NZ economy remaining immune. Cost and availability of credit continue to percolate as key themes behind the scenes. We can talk all we want about tax cuts, and infrastructure spending of 2 percent of GDP, along with the dairy payout. But the harsh reality is that credit is roughly 150 percent of GDP. Credit is where all the action is and will continue to be. We suspect it holds the key to prospects over the coming year, particularly in so far as being a principle driver of asset prices and the wealth effect. The latter is going to be absent over the coming year.

Looking at the local calendar this week, data is expected to depict slowing domestic demand, but persistent inflationary pressures. The REINZ report should once again be soft. With volumes light and

listings headed up, we expect the average days to sell to push beyond 40 days (s.a), which will portend of continue price weakness.

The retail sales data is expected to pull back after last month's surge. Volumes are looking soggy given food and petrol related inflation are siphoning money into core staples and away from discretionary items. It's a picture we expect to continue into 2008.

Producer price inflation is expected to come in strong courtesy of higher oil and commodity prices. Agri-inflation and seasonal factors are expected to underpin food prices for the month of January, giving a poor start to the March quarter CPI.

Recent data...

- > **NZ External Migration (December).** A net inflow of just 20 people occurred in December. This took the annual net inflow to 5,491.
- > **NZ LCI and QES (Dec qtr).** LCI private sector ordinary time wage rates rose by 1.1 percent in the quarter, taking annual growth to a record high 3.5 percent. The QES measure of wages rose by 0.9 percent (4.0 percent in annual terms). QES employment indicators were all strong.
- > **ANZ Commodity Price Index (January).** The world price index fell 1.4 percent, although is still up 27.4 percent in annual terms.
- > **NZ HLFS (Dec qtr).** Employment rose by 1.1 percent, the participation rate increased to 68.8 percent, and the unemployment rate fell to 3.4 percent.

OPINION: "WELL PLACED?"

Conventional wisdom (commentary) is that NZ is well placed to weather any international unease. While a sound macro framework certainly gives this an air of truth, the ability of traditional shock-absorbers to respond is not as strong as perhaps thought. Greater attention needs to be placed on increasing productivity growth as opposed to get-out-of-jail free cards from potential short-term stabilisation measures.

The conventional wisdom is that NZ is well placed to weather any downturn. The combination of a huge fiscal war-chest, an independent central bank and free floating currency, could be expected to be powerful shock-absorbers dampening any downside risk to the economy. Such forces are testament to a strong economic framework.

On any dislocation, the NZ dollar has traditionally adjusted lower – sharply, and the Reserve Bank can loosen monetary policy, thereby loosening financial conditions. There is certainly no shortage of cash in the fiscal coffers. This combination can be expected to put the economy back on a firm footing if any offshore event inspires a lull.

While we certainly concur with this sentiment, we thought it worth teasing out some of the limitations, or constraints at present on such forces acting, either in terms of magnitude or in a timely manner.

Limitation 1: Inflation. It's a problem. While economic theory – and our own faith in the monetary policy framework – dictates that inflation will not stay elevated in a weak economic environment, the case is not conclusive.

Businesses have a huge inflation pipeline. Government charges are exacerbating inflation pressure. Inflation expectations have been high for a number of years giving persistence to the inflation outlook. Fiscal policy is noted as a key inflation risk. There seems little prospect of monetary policy taking a pre-emptive stance. If rate cuts do end up being necessary, we suspect the horse will have bolted.

Limitation 2: Currency pygmy-nomics. If the NZ dollar is going down, who is going up? The USD looks sick and the NZD/AUD doesn't want to go down, despite clear divergences in paths for the two economies. The currency market is chasing pygmies, with each suffering from their own lack of height and attractiveness.

Limitation 3: Fiscal policy is a slow-moving beast. The lags between fiscal policy and the economy are massive. It takes time for fiscal policy to swing into gear. Tax cuts in the mid 1990's certainly didn't make one bit of difference once the combination of tight financial conditions, a drought, and Asian crisis hit.

Limitation 4: This cycle is different. The Reserve Bank found it relatively easy to reflate the economy in the 1990's. However, debt levels are now

higher and a greater proportion of borrowing is fixed. The 1997/98 recession was sharp, driven by a corporate led period of de-leveraging and consolidation. This time around, the vulnerabilities within the economy reside in the household sector. Given their poor savings rate, they could be far slower to de-leverage and recover.

Limitation 5: The nature of the offshore event. Global dislocation is credit dominated. We are heavily indebted. Enough said.

Limitation 6: Sustained "good times" have been overly capitalised. NZ continues to run a current account deficit of over 8 percent of GDP despite our terms of trade hitting a 30-year high. The NZ equity market is trading at a P/E higher than international peers. The boom to the dairy sector has been capitalised into farm values, as opposed seeking a sustainable return on the investment.

So where to from here?

Despite obvious limitations, the interaction of various shock absorbers will nonetheless play a role in stabilising prospects if conditions do deteriorate. But as far as the magnitude is concerned, we should not be expecting magic bullets to emerge. It's a little bit like having another drink the next day to get over the hangover.

The success of the economy in navigating through an uncertain global environment, high inflation, and imbalances such as a large current account deficit resides in one variable: productivity growth.

Productivity growth remains poor. As we've noted before, labour productivity growth across the market sector has averaged 1.3 percent since 2001, roughly half the rate seen during the 1990's. As noted on page 2, surveys such as the Quarterly Survey of Business Opinion depict strong appetites to hire but weak appetites to invest, despite relative price signals suggesting the reverse. It's a worrying combination in terms of where productivity performance is headed.

The upshot

Sound down-beat? Don't be alarmed. New Zealand's macro framework will continue to serve the economy well, it's just a question of degree. Within this cyclical bearish tone, the author remains a secular bull. It is partly out of frustration that these observations emerged. Strong commodity prices and global integration are presenting New Zealand with a phenomenal opportunity to once again return amongst the "rich nations".

For policy-makers this means far greater attention toward productivity growth to maximise opportunities and minimising current risks. But until we see evidence of improvements in productivity, we'll retain a degree of nervousness over how this business cycle will end. While there is a lot of "good" such as infrastructure spending occurring, other areas such as regulation and the growth in back office government spending are disconcerting.

GLOBAL WATCH

We present a table of global data outturns over the past week given the significance of the international backdrop at present. It was a quiet week for Asian data last week, although Japanese data generally printed on the soft side. The key development last week was further evidence of a pending recession in the US, with ISM non-manufacturing data particularly soft. Evidence is also growing that US weakness is broadening, with European PMI data hitting a four year low and UK industrial and manufacturing production below expectations.

Country/ Area	Indicator	Mkt	Actual	Last	Outturn vs market
US	Factory Orders (Dec)	2.5%	2.3%	1.7%	Weaker
	ISM Non-Manufacturing Business (Jan)	53.0	41.9	54.4	Weaker
	Non-Farm Productivity (4Q P)	0.5%	1.8%	6.0%	Stronger
	Unit Labour Costs (4Q P)	3.5%	2.1%	-1.9%	Stronger
	Pending Home Sales (Dec) – mom	-1.0%	-1.5%	-3.0%	Weaker
	Consumer Credit (Dec)	\$7.4B	\$4.5B	\$17.1B	Weaker
	Wholesale Inventories	0.3%	1.1%	0.8%	Weaker
	Europe	PPI (Dec) – yoy	4.3%	4.3%	4.2%
	PMI Services (Jan F)	50.6	52.0	52.0	Weaker
	PMI Composite (Jan F)	52.7	51.8	52.7	Weaker
	Retail Sales (Dec) – yoy	-0.8%	-2.0%	-1.2%	Weaker
	ECB Interest Rate Announcement	4.0%	4.0%	4.0%	In-line
UK	PMI Construction (Jan)	55.0	53.9	56.0	Weaker
	PMI Services (Jan)	52.0	52.5	52.4	Stronger
	Industrial Production (Dec) – mom	0.2%	-0.1%	-0.1%	Weaker
	Manufacturing Production (Dec) - mom	0.1%	-0.2%	-0.1%	Weaker
	BoE Interest Rate Announcement	5.25%	5.25%	5.50%	In-line
Asia Ex-Japan					
<i>Singapore</i>	PMI (Jan)	50.3	50.5	51.0	In-line
	Electronics Sector Index (Jan)	51.1	50.8	52.3	Weaker
<i>Indonesia</i>	Bank of Indonesia Interest Rate Announcement	8.00%	8.00%	8.00%	In-line
<i>Philippines</i>	CPI (Jan) – yoy	4.2%	4.9%	3.9%	Stronger
<i>Malaysia</i>	Industrial Production (Dec) – yoy	2.7%	5.7%	3.2%	Stronger
Japan	Monetary Base (Jan) – yoy	0.2%	-0.1%	0.4%	Weaker
	Machine Orders (Dec) – mom	-0.9%	-3.2%	-2.8%	Weaker
	Money Supply M2+CD (Jan) – yoy	2.1%	2.1%	2.1%	In-line
	Bank Lending ex Trusts (Jan) – yoy	0.2%	0.5%	0.1%	Stronger
	Eco Watchers Survey: Current (Jan)	35.6	31.8	36.6	Weaker
	Eco Watcher Survey: Outlook (Jan)	36.1	35.8	37.0	Weaker
Australia	House Price Index (4Q) – qoq	3.0%	3.2%	3.2%	Stronger
	Retail Sales (Dec) – mom	0.6%	0.5%	0.8%	In-line
	Building Approvals (Dec) – mom	-4.0%	-16.0%	8.2%	Weaker
	RBA Interest Rate Announcement	7.00%	7.00%	6.75%	In-line

INTEREST RATE STRATEGY

Last week's NZ labour market data will mean the trading market will keep a pay-side bias. It is expected that mortgage books will dominate flow this week as offshore accounts are expected to step back from New Zealand. Curves are expected to flatten, which goes against our view for offshore curves.

Market themes...

- > Mortgage flows to dominate as offshore accounts step back from New Zealand.
- > Credit concerns continue, which will see swap spreads wider.
- > US 2-year notes continue to gain as traders bet the Federal Reserve will cut interest rates again next month.
- > The RBA is still in play. The RBNZ experience in 2007 may be a useful roadmap for the RBA.

Outlook...

Last week's labour data will be worrying for the Reserve Bank. If we didn't have the backdrop of global concerns then the New Zealand market would be pricing in more than it currently is. However the strength of the data will mean that pull-backs in short term rates will be met by payers – mostly led by mortgage books. Offshore accounts seem to have been spooked by the labour data and are expected to step back from the New Zealand rates market. The NZ IRS curve looks very expensive against offshore markets and accounts will be reluctant to pay at current levels, hence mortgage books will dominate. Last week saw the 2-year IRS move from 8.53 percent to 8.60 percent in very short time, all led by mortgage flow. One offshore flow (Uridashi related) saw markets correct to 8.54 percent. This type of price action is more than likely to be the case again this week.

Credit concerns should see swaps widen again this week. London price action on Friday is a theme that is not going away anytime soon. More writedowns and more problems expected. CDS & Cash all move wider, structured credit funds push CDS wider as they buy default protection to offset losses in CDS books. UK Prime RMBS trades +120 over – low rates in the U.S are of little use. It is this type of price that will at some stage feed into the NZ markets, a large reason that offshore accounts will sit out till the data turns.

US 2-year notes on Friday gained for an eighth straight week – the longest rally since 1998 – on mounting speculation the economy will sink into a recession. The market continues to think the Federal Reserve will cut interest rates next month for the sixth time since September.

Gauges for NZ interest rates yields

Gauge	Direction	Comment
RBNZ	↔	Holding, watching and waiting to see how global developments unfold.
NZ data	↔	Labour market data has reinforced higher for longer rates outlook.
Fed Funds/front end	↓	Fed delivers another 50bp cut and market looking for more cuts in coming months.
RBA	↑	25pbs delivered, but RBA still has a lot of work to do.
US 10 year	↔/↓	Inflation worries still lingering, but downside growth risks dominate for now.
NZ swap spreads	↔/↓	In consolidation mode but credit concerns can see spreads wider.
Flow	↔/↑	Pay-side bias led by mortgage books after last week's data.
Technicals	↔/↓	Further pressure for US curve to steepen.

Borrowing strategies we favour at present

We envisage the recent push higher in swap yields as an opportunity to reduce cover. As such we favour fixed rate payers target the 1-2 year areas of the curve as currently generating best value. For now we are "neutral payers" of 5 year swap whilst it ranges 8.10-8.25 percent. Those looking to pay further out are advised to be patient.

Probability of 25bps increase as implied by market pricing

OCR dates	Last week	This week
Thu 6-Mar-08	8	11
Thu 24-Apr-08	12	22
Thu 5-Jun-08	10	30
Thu 24-Jul-08	-6	26
Thu 11-Sep-08	-50	6
Thu 23-Oct-08	-50	6
Thu 4-Dec-08	-106	-26

Trading themes we favour at present

We have taken profit on our 2-year position. We now look to buy Sep 08 futures and sell Dec 08 futures at -17 points targeting a move to -12 points without taking on a lot of directional risk.

CURRENCY STRATEGY

Sentiment looks to be again turning bearish global prospects, and although yield demand will continue to provide support, the NZD is looking tippy around current levels. Local data this week will highlight waning domestic demand.

Market themes...

- > Global sentiment continues to sour.
- > Local data this week to highlight weak demand.
- > Why the NZD/AUD remains strong is puzzling.

Outlook...

We are beginning to sound like a broken record, but it was once again another volatile week for the NZD. After beginning the week on an upward march as yield demand dominated taking the kiwi to 0.7970 against the USD, selling interests emerged in the second half of the week as global growth concerns intensified.

So what do we know from last week?

- The US economic outlook continues to deteriorate, with ISM non-manufacturing data falling to the lowest level in seven years.
- Weakness is broadening, with European PMI's also softening, providing renewed support to the greenback and hence capping any significant gains for the NZD/USD.
- Conditions across credit markets continue to deteriorate, with global swap spreads, CDO's and Australian iTraxx widening.
- The AUD – a key bellwether of the global growth cycle - continues to struggle, despite the RBA hiking and delivering a tightening bias. Gains post-hike were short-lived as equity market sentiment turned.
- Central bank rhetoric can quickly turn, with even the ECB starting to soften their tone in the face of a deteriorating macro picture.

Such a combination continues to lean against the massive yield differential in favour of the NZD. A NZ-US 2-year swap differential nearing 590 basis points, along with news of further Uridashi issuance indicates that support is likely to remain robust.

But for now we expect renewed global growth concerns to dominate and the NZD to initially test support levels. Looking at the broad macro picture domestically, there is no doubt the economy is getting good support from areas such as the labour market. But early reads on 2008 are looking dicey, and we suspect we have seen the last of the "positives" supporting the bird.

Data this week is expected to reinforce our long-held view that the Australian economy is stronger than NZ's at present and we favour a move lower for this cross this week. The fact it is failing to budge is testament to wariness over the global growth cycle. But the currency market cannot have it both ways. If the

global economy is ok, then certainly the NZD/USD should remain high, but the relative domestic picture should push the NZD/AUD lower. Markets appear to be hedging their bets at present, which leaves us wary of a big figure move, particularly if NZ's domestic story unfolds.

Technically, NZD has major resistance at the 0.7920/0.7970 band. We must treat this level as the pivot. The NZD/AUD rally last week has run into good resistance at the 0.8850 level and again momentum is waning. We see the risk of an aggressive NZD move to the downside more likely as new highs are struggling to be achieved.

NZD vs AUD: monthly directional gauges		
Gauge	Direction	Comment
Fair value	↓	Growth differentials favouring AUD.
Yield	↔/↓	Yield spreads narrowing. Labour data just a hiccup.
Commodities	↓	Gold, iron ore, coal all up....milk down.
Partial indicators	↓	Better across the Tasman. Terms of trade shocks bigger there.
Technicals	↓	Top at 0.8860.
Sentiment	↓	AUD data is better.
Other	↓	RBNZ hold, RBA catchup.
On balance	↓	AUD simply better.

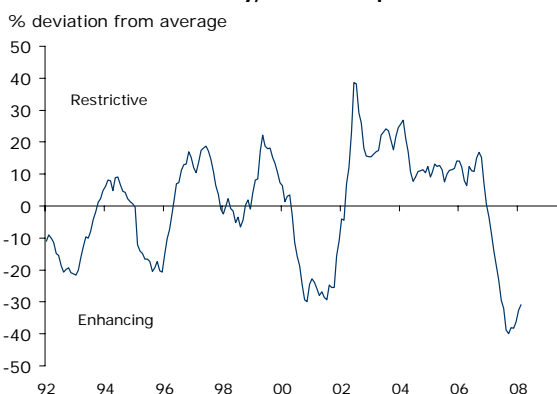
NZD vs USD: monthly directional gauges		
Gauge	Direction	Comment
Fair value – long-term	↓	Fair value 0.65 (and rising) given a structural shift in commodity prices.
Fair value – short-term	↔	Yield and commodity story factored in.
Yield	↑	Yield differentials at phenomenal levels.
Commodities	↔	Off highs but still high.
Risk aversion	↓	VIX Index high and credit concerns rising again.
Partial indicators	↑	NZ domestic economy is soft, but US is softer.
Technicals	↔	Topside momentum waning. Downside risks growing.
AUD	↑/↔	Good fundamentals but a play on global cycle.
Sentiment	↔	Mixed messages.
Other	↔	USD disliked, but US weakness broadening = period of sub-trend NZ growth.
On balance	↔	Neutral for now, but close to major turn.

EFFECTIVE EXCHANGE RATES UPDATE

Regular readers will know that we track real effective exchange rate measures across various export industries. These measures adjust for the impact of commodity prices and are weighted by export destination. They highlight that the performance of the NZD has a contrasting impact on different sectors of the New Zealand export community.

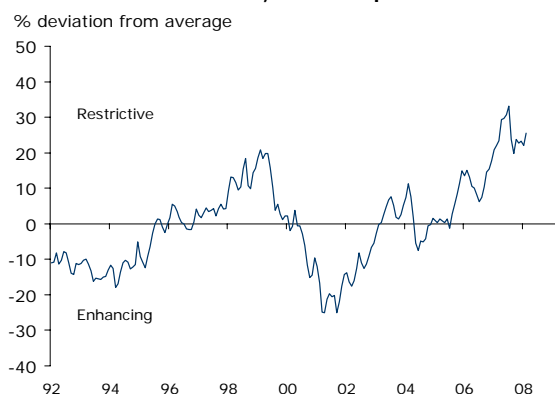
With the NZD finding renewed strength, and commodity prices generally softening, all the commodity adjusted real exchange rates we monitor deteriorated over the past month. The most notable movements were for the dairy sector, whose real exchange rate has appreciated in four out the past five months and is at its highest level since June 2007, along with strong increases for the manufacturing and services sectors. With the exception of the dairy, crude and seafood sectors, all the other export sectors continue to struggle under the weight of the high NZD.

Sector: Dairy, ≈18% of exports



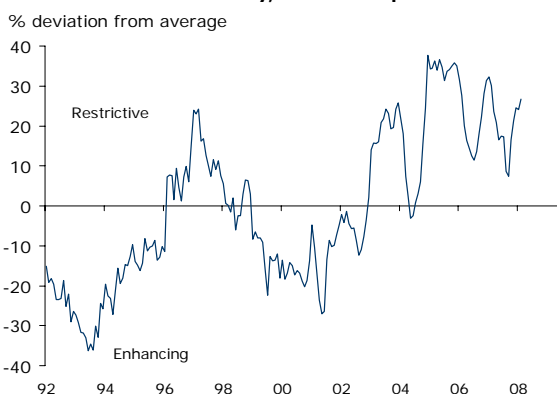
Sources: ANZ National, Bloomberg, Statistics NZ

Sector: Meat, ≈8% of exports



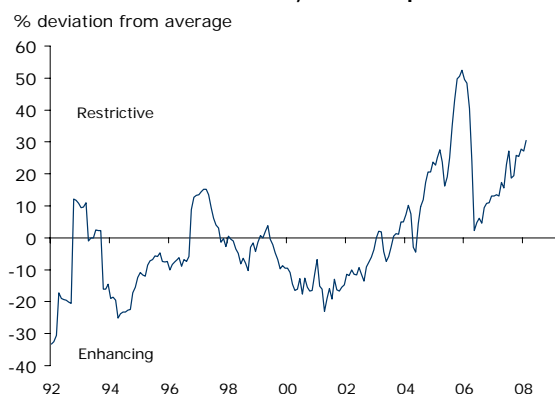
Sources: ANZ National, Bloomberg, Statistics NZ

Sector: Forestry, ≈10% of exports



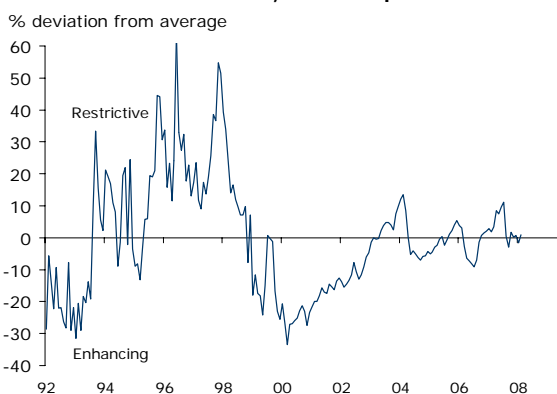
Sources: ANZ National, Bloomberg, Statistics NZ

Sector: Horticulture, ≈4% of exports



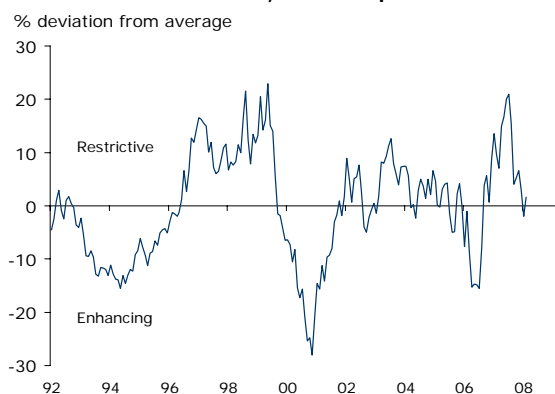
Sources: ANZ National, Bloomberg, Statistics NZ

Sector: Seafood, ≈3% of exports



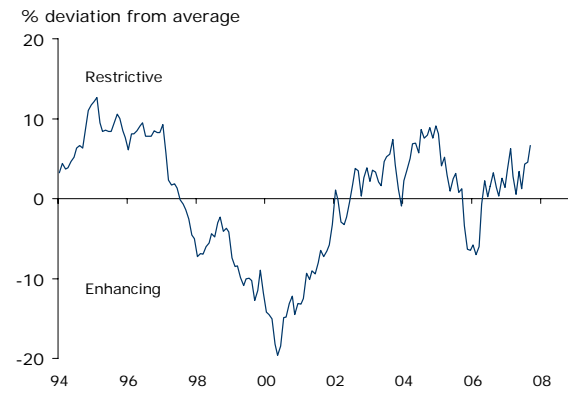
Sources: ANZ National, Bloomberg, Statistics NZ

Sector: Crude, ≈5% of exports



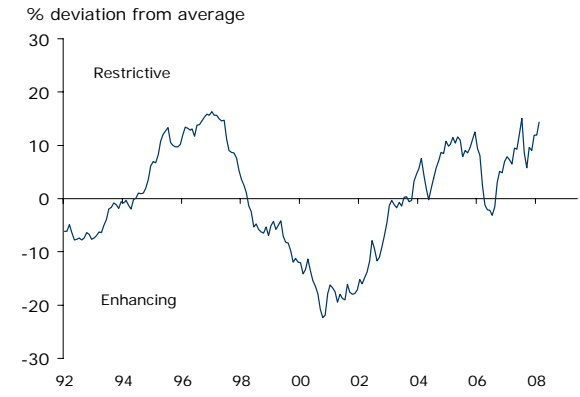
Sources: ANZ National, Bloomberg, Statistics NZ

Sector: Manufacturing, ≈20% of exports



Sources: ANZ National, Bloomberg, Statistics NZ

Sector: Services, ≈24% of exports



Sources: ANZ National, Bloomberg, Statistics NZ

DATA AND EVENT CALENDAR

Date	Country	Data/Event	Mkt.	Last	Time (NZDT)
11 Feb	AU	Home Loans (Dec)	-1.0%	4.0%	13:30
		Investment Lending (Dec)	-	-2.8%	13:30
		ANZ Job Advertisements (Jan) – mom	-	7.1%	13:30
		RBA Quarterly Monetary Policy Statement	-	-	13:30
	UK	PPI Input (Jan) – mom	1.0%	0.5%	22:30
		PPI Output (Jan) – mom	0.4%	0.5%	22:30
		PPI Output – core (Jan) – mom	0.3%	0.4%	22:30
		Total Trade Balance (Dec)	-4,400m	-4,371m	22:30
		DCLG House Prices (Dec) – yoy	8.0%	9.5%	22:30
12 Feb	US	Fed's Poole speaks about being Fed Bank President in St. Louis	-	-	12:00
	AU	NAB Business Confidence (Jan)	-	5	13:30
		NAB Business Conditions (Jan)	-	17	13:30
	UK	CPI (Jan) – mom	-0.6%	0.6%	22:30
		CPI (Jan) – yoy	2.3%	2.1%	22:30
		CPI – Core (Jan) – yoy	1.5%	1.4%	22:30
		RPI (Jan) – yoy	4.1%	4.0%	22:30
	GE	ZEW Survey (Economic Sentiment) (Feb)	-45.0	-41.6	23:00
		ZEW Survey (Current Situation) (Feb)	50.0	56.6	23:00
	EU	ZEW Survey (Economic Sentiment) (Feb)	-43.0	-41.7	23:00
13 Feb	EU	ECB's Liikanen speaks in Helsinki	-	-	02:30
		Industrial Production (Dec) – mom	0.6%	-0.5%	23:00
	US	IBD/TIPP Economic Optimism (Feb)	42.8	43.2	04:00
		Fed's Yellen speaks on Economy in San Francisco	-	-	05:05
		Monthly Budget Statement (Jan)	\$20.0B	\$38.2B	08:00
	NZ	PPI – Inputs (4Q) – qoq	-	2.3%	10:45
		PPI – Outputs (4Q) – qoq	-	1.6%	10:45
	AU	Westpac Consumer Confidence (Feb)	-	-8.3%	12:30
	JN	Domestic CGPI (Jan) – mom	0.0%	0.4%	12:50
		Current Account Total (Dec)	1,713.8B	1,782.5B	12:50
		Bankruptcies (Jan) – yoy	-	-1.0%	17:30
		Consumer Confidence - Households (Jan)	37.5	38.0	18:00
	UK	Claimant Count Rate (Jan)	2.5%	2.5%	22:30
		Jobless Claims Change (Jan)	-5.0k	-6.4k	22:30
		Average Earnings inc Bonus (Dec) – 3m/yoy	3.9%	4.0%	22:30
		ILO Unemployment Rate (Dec) – 3mths	5.3%	5.3%	22:30
		BoE Quarterly Inflation Report	-	-	23:30
14 Feb	US	Advance Retail Sales (Jan)	-0.3%	-0.4%	02:30

Continued over page

Date	Country	Data/Event	Mkt.	Last	Time (NZDT)
14 Feb cont.	US	Retail Sales Less Autos (Jan)	0.2%	-0.4%	02:30
		Business Inventories (Dec)	0.5%	0.4%	04:00
		Fed's Bernanke, Paulson, Cox Testify Before Senate Committee	-	-	18:00
	NZ	Food Prices (Jan) – mom	-	0.9%	10:45
		Business NZ PMI (Jan)	-	53.8	12:00
	AU	Consumer Inflation Expectation (Feb)	-	13.7%	12:30
		Unemployment Rate (Jan)	4.3%	4.3%	13:30
		Participation Rate (Jan)	65.2%	65.2%	13:30
		Employment Change (Jan)	15.0k	20.1k	13:30
	JN	GDP (4Q P) – qoq	0.4%	0.4%	12:50
		GDP Annualised (4Q P)	1.7%	1.5%	12:50
		GDP Deflator (4Q P) – yoy	-0.9%	-0.4%	12:50
		Industrial Production (Dec F) – mom	1.4%	1.4%	17:30
		Capacity Utilisation (Dec F)	-	108.4	17:30
	GE	GDP (4Q P) – qoq	0.3%	0.7%	20:00
		GDP (4Q P) – yoy	1.8%	2.4%	20:00
	EU	ECB's Liikanen speaks in Helsinki	-	-	20:30
		ECB Publishes Monthly Report	-	-	22:00
		GDP (4Q A) – qoq	0.3%	0.7%	23:00
		GDP (4Q A) – yoy	2.2%	2.7%	23:00
15 Feb	US	Trade Balance (Dec)	-\$61.5B	-\$63.1B	02:30
		Fed's Evans speaks on US Economic Outlook in Chicago	-	-	07:30
	EU	ECB's Trichet Speaks in Barcelona	-	-	06:30
		Trade Balance (Dec) – s.a.	0.5B	2.7B	23:00
	NZ	Retail Sales (Dec) – mom	-	2.0%	10:45
		Retail Sales Ex-Auto (Dec) – mom	-	0.9%	10:45
		Retail Sales Ex Inflation (4Q) – qoq	-	0.2%	10:45
	JN	BoJ Interest Rate Announcement	0.50%	0.50%	-
		BoJ Monthly Report	-	-	19:00
16 Feb	US	Import Price Index (Jan) – mom	0.4%	0.0%	02:30
		Empire Manufacturing (Feb)	6.5	9.0	02:30
		Net Long-Term TIC Flows (Dec)	\$69.0B	\$90.9B	03:00
		Total Net TIC Flows (Dec)	\$67.5B	\$149.9B	03:00
		Industrial Production (Jan)	0.1%	0.0%	03:15
		Capacity Utilisation (Jan)	81.4%	81.4%	03:15
		University of Michigan Confidence (Feb P)	76.0	78.4	04:00
	EU	ECB's Trichet speaks in Madrid	-	-	03:45

Key: AU: Australia, EU: Euro-zone, GE: Germany, JN: Japan, NZ: New Zealand, UK: United Kingdom, US: United States. Sources: Dow Jones, Reuters, Bloomberg, ANZ National Bank. All \$ values in local currency. (Note: all surveys are preliminary and subject to change).

NEW ZEALAND DATA WATCH

Key focus over the next four weeks: Labour market data highlighted the extent of late cycle economic support and inflationary risks facing the Reserve Bank. However, attention should now return to evidence of domestic demand continuing to slow, with REINZ housing data and retail sales data this week, in particular, expected to print on the soft side.

Date	Data/Event	Economic Signal	Comment
circa 11 Feb	REINZ Housing Report (Jan)	Down	The major indicator here is average days to sell a house. With Barfoot and Thompson data showing listings rising and sales subdued, we expect this to rise beyond last month's level of 40 days (seasonally adjusted).
Wed 13 Feb (10.45)	Producer Price Index (Dec qtr)	Margin squeeze	Business margins expected to remain under pressure, judging from the QSBO survey. This points to more potential cost-push inflation pressure.
Wed 13 Feb (10.45)	Capital Goods Price Index (Dec qtr)	Mixed on the price front	P&M prices to fall due to higher TWI, but residential and non-residential building prices to remain strong, though showing some signs of easing.
Thu 14 Feb (10.45)	Food Price Index (Jan)	On the up	January is usually a strong month for food prices, and this year will be no different. With world commodity prices still riding high, there is further agri-inflation in the works.
Fri 15 Feb (10.45)	Retail Trade Survey (Dec)	Flat-lining	After a strong surge in November, a pullback can be expected. Credit card and ECT data point to a soft print. We expect a small decline in headline sales. For the quarter, real growth is also likely to be soft.
Thu 21 Feb (15.00)	NBNZ <i>Regional Trends</i> (Mar qtr)	-	-
Fri 22 Feb (15.00)	Credit Card Billings (Jan)	Rebound?	Following a weak December, anecdotes suggest January was a better month for retailers. This could see a rebound in credit card billings, though overall spending still slowing.
Wed 27 Feb (10.45)	Building Consents (Jan)	Soft	An easing trend is now clearly in place. Based on the falls in house sales, a further decline in consent issuance is expected.
Thu 28 Feb (10.45)	External Migration (Jan)	Steady	We expect annual migration to stabilise around current levels of 5,000, although the risks appear skewed to the downside.
Thu 28 Feb (15.00)	NBNZ <i>Business Outlook</i> (Feb)	-	-
Fri 29 Feb (10.45)	Overseas Merchandise Trade (Jan)	Improving	Another small trade surplus is expected following the surprise surplus in December. The impact of high dairy prices is increasing as the milk production ramps up, although dry conditions may weigh on this slightly.
Tue 4 Mar (10.45)	ANZ Commodity Price Index (Feb)	-	-
Wed 5 Mar (10.45)	Wholesale Trade Survey (Dec qtr)	Softening	Wholesale trade activity is expected to soften in line with slowing activity in the retail sector.
Thu 6 Mar (09.00)	RBNZ <i>Monetary Policy Statement</i>	Watching and waiting	The Reserve Bank won't have liked the messages from the labour market. But global conditions are weaker and so is housing. Expect a similar message to January.
Fri 7 Mar (10.45)	Value of Building Work Put in Place (Dec qtr)	Easing	Given an easing trend present in building consent issuance, we expect residential construction activity to detract from growth in the December quarter.
On Balance		Sub-trend growth	Inflationary pressures persist, but domestic demand waning.

SUMMARY OF KEY ECONOMIC FORECASTS

	Dec-06	Mar-07	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09
GDP (% qoq)	0.7	1.2	0.8	0.5	0.3	0.3	0.3	0.3	0.5	0.6
GDP (% yoy)	2.0	2.4	3.2	3.3	2.9	1.9	1.4	1.2	1.4	1.7
CPI (% qoq)	-0.2	0.5	1.0	0.5	1.2	0.6	0.8	0.9	0.8	0.5
CPI (% yoy)	2.6	2.5	2.0	1.8	3.2	3.3	3.0	3.4	3.0	2.9
Employment (% qoq)	0.1	1.2	0.6	-0.3	1.1	0.4	0.3	0.2	0.3	0.1
Employment (% yoy)	1.4	1.7	1.6	1.6	2.5	1.8	1.5	2.0	1.2	0.9
Unemployment Rate (% sa)	3.8	3.7	3.6	3.5	3.4	3.7	3.8	3.8	4.0	4.1
Current Account (% GDP)	-8.6	-8.2	-8.1	-8.3	-8.0	-7.6	-7.0	-6.7	-6.8	-6.9
Terms of Trade (% qoq)	2.5	1.5	0.4	3.7	2.7	0.8	-0.1	-0.2	0.0	-0.4
Terms of Trade (% yoy)	3.8	4.5	2.3	8.4	8.5	7.8	7.2	3.3	0.6	-0.7

KEY ECONOMIC INDICATORS

	Apr-07	May-07	Jun-07	Jul-07	Aug-07	Sep-07	Oct-07	Nov-07	Dec-07	Jan-08
Retail Sales (% mom)	-1.2	1.1	-0.4	0.2	0.3	1.0	-0.6	2.0
Retail Sales (% yoy)	7.4	6.7	4.8	5.7	6.3	4.1	5.5	6.9
Credit Card Billings (% mom)	-1.1	1.0	1.8	0.1	0.5	2.4	-0.6	1.2	0.3	..
Credit Card Billings (% yoy)	7.9	5.8	8.9	7.9	8.6	9.4	7.7	9.5	7.6	..
Car Registrations (% mom)	-1.6	6.1	-4.7	7.0	1.1	-6.7	5.6	-3.6	-2.6	..
Car Registrations (% yoy)	-4.8	-2.5	-1.5	7.0	10.9	0.1	4.7	2.3	1.4	..
Building Consents (% mom)	0.3	4.9	12.3	-15.6	4.9	-9.8	-4.7	-0.1	-5.2	..
Building Consents (% yoy)	9.0	2.9	33.0	-4.2	-1.5	-15.4	-16.0	-4.9	-6.7	..
REINZ House Price (% yoy)	14.4	14.8	12.1	10.4	12.9	12.3	8.0	6.7	4.5	..
Household Lending Growth (% mom)	1.0	1.0	1.1	0.9	0.9	0.8	0.8	0.8	0.7	..
Household Lending Growth (% yoy)	13.5	13.5	13.5	13.5	13.4	13.0	12.8	12.6	12.2	..
Roy Morgan Consumer Confidence	128.6	122.1	121.0	121.1	122.4	121.3	122.0	121.9	126.6	121.2
NBNZ Business Confidence	-19.4	-48.3	-37.2	-38.5	-33.8	-26.5	-12.9	-19.6	-24.9	..
NBNZ Own Activity Outlook	22.5	7.8	14.8	12.4	16.7	17.2	20.3	15.7	18.2	..
Trade Balance (\$m)	-215	8	-518	-808	-947	-572	-773	-628	33	..
Trade Balance (\$m annual)	-6024	-5900	-6226	-6340	-6336	-6282	-5882	-5690	-5311	..
ANZ World Commodity Price Index (% mom)	4.9	2.6	6.3	4.6	1.4	0.4	1.8	0.8	0.0	-1.4
ANZ World Commodity Price Index (% yoy)	20.9	21.1	29.8	35.1	36.3	35.7	37.8	35.9	30.9	27.4
Net Migration (sa)	240	430	620	490	740	680	280	530	20	..
Net Migration (annual)	11222	10682	10078	8966	8730	8309	7517	6588	5491	..

Figures in bold are forecasts. mom: Month-on-Month qoq: Quarter-on-Quarter yoy: Year-on-Year

SUMMARY OF KEY MARKET FORECASTS

NZ FX rates	Actual		Current	Forecast (end month)						
	Dec 07	Jan 08	11 Feb 08	Mar 08	Jun 08	Sep 08	Dec 08	Mar 09	Jun 09	Sep 09
NZD/USD	0.768	0.772	0.787	0.780	0.770	0.730	0.680	0.660	0.640	0.630
NZD/AUD	0.881	0.876	0.878	0.857	0.856	0.830	0.791	0.786	0.780	0.788
NZD/EUR	0.528	0.524	0.542	0.523	0.513	0.500	0.479	0.478	0.478	0.485
NZD/JPY	86.3	83.2	84.4	85.8	83.2	77.4	70.7	69.3	69.1	69.3
NZD/GBP	0.380	0.392	0.404	0.396	0.395	0.378	0.358	0.351	0.344	0.342
NZ\$ TWI	71.6	71.2	72.7	71.5	70.5	67.5	63.5	62.5	61.7	61.7
NZ interest rates	Dec 07	Jan 08	11 Feb 08	Mar 08	Jun 08	Sep 08	Dec 08	Mar 09	Jun 09	Sep 09
OCR	8.40	8.38	8.25	8.25	8.25	8.00	7.50	7.00	6.75	6.75
90 day bill	8.90	8.75	8.74	8.70	8.60	8.00	7.50	7.00	7.00	7.00
10 year bond	6.39	6.28	6.39	6.20	6.10	6.00	5.50	5.40	5.60	5.80
International	Dec 07	Jan 08	11 Feb 08	Mar 08	Jun 08	Sep 08	Dec 08	Mar 09	Jun 09	Sep 09
US Fed funds	4.25	3.00	3.00	2.75	2.25	2.00	2.00	2.50	3.25	3.75
US 3-mth	4.70	3.11	3.09	3.40	3.25	3.15	3.25	3.65	4.15	4.50
AU cash	6.75	6.75	7.00	7.00	7.25	7.25	7.25	7.25	7.25	7.25
AU 3-mth	7.24	7.35	7.46	7.30	7.50	7.50	7.50	7.50	7.40	7.40

KEY RATES

	8 Jan	4 Feb	5 Feb	6 Feb	7 Feb	8 Feb
Official Cash Rate	8.25	8.25	8.25	n/a	8.25	8.25
90 day bank bill	8.75	8.72	8.74	n/a	8.77	8.75
NZGB 07/09	7.24	7.21	7.23	n/a	7.25	7.27
NZGB 11/11	7.02	6.97	6.98	n/a	7.00	7.02
NZGB 04/13	6.94	6.86	6.85	n/a	6.86	6.88
NZGB 12/17	6.26	6.30	6.34	n/a	6.35	6.38
2 year swap	8.57	8.40	8.47	n/a	8.52	8.55
5 year swap	8.08	7.96	8.01	n/a	8.04	8.07
RBNZ TWI	71.4	72.5	72.5	n/a	72.3	73.0
NZD/USD	0.7714	0.7921	0.7920	n/a	0.7849	0.7902
NZD/AUD	0.8781	0.8753	0.8738	n/a	0.8803	0.8814
NZD/JPY	84.34	84.67	84.57	n/a	83.47	84.83
NZD/GBP	0.3912	0.4025	0.4016	n/a	0.4007	0.4064
NZD/EUR	0.5243	0.5349	0.5346	n/a	0.5370	0.5451
AUD/USD	0.8785	0.9049	0.9064	n/a	0.8916	0.8965
EUR/USD	1.4713	1.4808	1.4814	n/a	1.4616	1.4496
USD/JPY	109.34	106.89	106.78	n/a	106.34	107.35
GBP/USD	1.9719	1.9679	1.9722	n/a	1.9589	1.9443
Oil	95.08	89.03	90.07	n/a	87.16	88.07
Gold	862.70	909.88	902.40	n/a	901.13	911.00
Electricity (Haywards)	5.79	22.57	10.91	7.77	11.12	11.31
Milk futures (US\$/contract)	153	137	137	137	137	137
Baltic Dry Freight Index	8730	6121	6032	6002	6135	6353

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ANZ, Level 7, 1 Victoria Street, Wellington 6011, New Zealand Phone 64-4-802 2000 Fax 64-4-496 8639
<http://www.anz.com/nz> e-mail ecnmcs@anz.com